STATE BOARD OF EQUALIZATION
STAFF LEGISLATIVE BILL ANALYSIS

DRAFT

Date Amended:	**03/29/05**	Bill No:	**SB 998**
Tax:	**Sales and Use**	Author:	**Margett**
Related Bills:	**AB 236 (Bermudez)**		

BILL SUMMARY

This bill would exempt from the sales tax that portion of fuel and petroleum products sold to an air common carrier that remains on board after the air common carrier reaches its first out-of-state destination.

Summary of Amendments

The March 29, 2005 amendments deleted the operative date of January 1, 2008.

ANALYSIS

Current Law

Under existing law, Section 6385 of the Revenue and Taxation Code provides a sales tax exemption for that portion of fuel and petroleum products sold to a water common carrier that remains on board after the water common carrier reaches its first out-of-state destination. This section additionally provides a sales tax exemption for tangible personal property, other than fuel and petroleum products, sold to air, water, and rail common carriers when that property is shipped to a point outside this state under specified conditions.

With respect to air common carriers, Section 6357.5 provides an exemption for the sale or purchase of fuel and petroleum products sold to air common carriers when the fuel and petroleum products are for immediate consumption or shipment in the conduct of the air carrier's business on an international flight. Therefore, if an air common carrier's final destination were France, for example, current law would exempt the entire sale of fuel purchased in California, even if that carrier had stops in Los Angeles and New York before reaching its final destination. On the other hand, if the air carrier's final destination was somewhere in the United States, current law would impose tax on the entire sale of the fuel in California.

Proposed Law

This bill would add Section 6385.5 to the Sales and Use Tax Law to provide a sales tax exemption for the sale of fuel and petroleum products to air common carriers for immediate shipment outside this state for consumption in the conduct of its business as a common carrier after the first out-of-state destination. If enacted, only that portion of fuel used to reach the air common carrier's first out-of-state destination would be subject to tax provided the carrier purchased fuel in California for use in its business as a common carrier for immediate use outside this state. The remaining portion would be exempted by the provisions of this bill (unless, however, the air common carrier is on an international flight, in which case, the sale of fuel would be entirely exempt under current law).

This bill defines the term "domestic flight" to mean a flight whose final destination is a point inside of the United States, including its territories.

This bill also defines the term "immediate consumption or shipment" to mean that the delivery of the fuel and petroleum products into an aircraft is made directly into an aircraft for consumption or transportation on a domestic flight and not for storage by the purchaser or any third party.

Background

Until July 15, 1991, sales of fuel and petroleum products to air, water, and rail common carriers were exempt from sales tax when used in the conduct of the carriers' common carrier activities after the first out-of-state destination. The rationale for this exemption was that it made California ports and airports more competitive, and it established consistency in the Sales and Use Tax Law for interstate and foreign commerce sales by exempting that portion of the fuel which was actually transported outside this state prior to any use. However, because of the budget crisis in 1991, this exemption was repealed by AB 2181 (Stats. 1991, Ch. 85) and SB 179 (Stats. 1991, Ch. 88).

In 1992, however, AB 2396 (Ch. 905) restored this exemption for fuel and petroleum products, but only with respect to water common carriers, and only until January 1, 1998. The sponsors of that measure, Pacific Merchant Shipping Association, successfully argued before the Legislature that the July 1991 repeal of the exemption had been directly responsible for a decline in the number of ships which bunker in California ports, and that reinstating the exemption would increase bunker activity in California. The sunset date of January 1, 1998 was extended until January 1, 2003 by AB 366 (Stats. 1997, Ch. 615). Subsequent legislation extended the sunset date to January 1, 2014 (Ch. 712, SB 808, Stats. 2003).

Two bills to restore the exemption for air and rail common carriers were introduced in the 1996 Legislative Session. AB 3375 (Olberg) would have restored the exemption for rail common carriers. AB 566 (Kaloogian) would have restored the exemption for air common carriers. According to a Department of Finance analysis of AB 566, "Governor Wilson has proposed a different form of tax relief for the aircraft industry. Under the Governor's proposal, a sales tax exemption would be extended to property that becomes a component part of an exempt aircraft as a result of maintenance, repair, overhaul, or improvement of the aircraft in compliance with FAA requirements." The Governor's proposal was actually enacted in the 1996 Legislative Session by SB 38 (Lockyer, et al., Stats. 1996, Ch. 954) which, among other things, included the sales tax exemption for the component parts.

Three bills, similar to this bill, would have exempted from sales tax that portion of fuel and petroleum products sold to an air common carrier that is left on board after the air common carrier reaches its first out-of-state destination. AB 1800 (Machado), introduced during the 1998 Legislative Session, failed to pass the Assembly Appropriations Committee. AB 2470 (Wiggins), introduced during the 2000 Legislative Session, failed to pass the Assembly Revenue and Taxation Committee. SB 1510

(Knight), introduced during 2002 Legislative Session, died in Senate Revenue and Taxation Committee.

AB 2897 (Wiggins), introduced during the 2002 Legislative Session, would have exempted from the sales and use tax, those gross receipts in excess of $0.50 per gallon on the sale or purchase of fuel and petroleum products by an air common carrier. This bill was held under submission in the Assembly Appropriations Committee.

COMMENTS

1. **Sponsor and Purpose.** This bill is sponsored by the Air Transport Association of America to reinstate the partial exemption on fuel sold to air common carriers that existed before 1991 but was repealed due to budget constraints. In 1992, the Legislature passed AB 2396 (Ch. 905, Elder), which reinstated the partial sales and use tax exemption for bunker fuel sales to water common carriers. The partial exemption was due to sunset by 2003. The Legislature passed SB 808 (Ch. 712, Karnette) which extended the exemption to January 1, 2014. However, no such exemption has been reinstated for air common carriers.

   According to the sponsor, the lost sales tax exemption on fuel (except international airlines) has cost the airline industry over $400 million. Since 2001, the airline industry has lost over $33 billion ($9.5 billion in 2004) and 126,000 jobs (19,000 in California), and they estimate losses in 2005 now stand at $5 billion.

2. **The May 29, 2005 amendments** deleted the operative date of January 1, 2008. If enacted, the provisions of this bill would become operative on January 1, 2006.

3. **Reinstatement of the exemption would not be problematic for the Board.** Since the Board has previously administered this bill's proposed exemption, we do not anticipate any administrative problems with its reinstatement.

4. **Technical amendment suggested.** Since Section 6357.5 of the Sales and Use Tax Law provides that the entire sale of fuel is exempted if sold to an air common carrier on an international flight, it is recommended that "and except as provided in Section 6357.5" be added after "Section 6385," on page 2, line 3, in order to avoid any conflict.

5. **Related Legislation.** AB 236 (Bermudez) would exempt from the sales and use tax, those gross receipts in excess of $0.632 per gallon on the sale or purchase of fuel and petroleum products to an air common carrier on a domestic flight. The provisions of this bill would sunset on January 1, 2010.

COST ESTIMATE

Some costs would be incurred in notifying affected taxpayers, modifying tax returns, revising regulations and pamphlets, and answering inquiries from industry and the public. A detailed cost estimate is pending.

REVENUE ESTIMATE

Background, Methodology, and Assumptions

This bill would exempt from the sales and use tax that portion of fuel and petroleum products sold to air common carrier for immediate shipment outside this state for consumption in the conduct of its business as a common carrier after the first out-of-state destination.

According to the Energy Information Administration, total sales of jet fuel in California for the year 2003 amounted to 3.5 billion gallons. According to the Bureau of Transportation Statistics, it is estimated that 27 percent of all fuel is consumed by air common carriers with foreign destinations. Fuel consumed by air common carriers whose final destination is a foreign country is currently exempt from the sales and use tax. Therefore, the total gallonage used by air common carriers for domestic flights is 2.56 billion gallons (3.5 billion gallons X .73).

Based upon the figures provided by the Air Transport Association, the total fuel consumption attributable to usage after the first out-of-state destination that would qualify under this billl is 383.3 million gallons, or 15 percent of total consumption.

According to the Energy Information Administration, the average annual price of jet fuel sold in California during 2004 was $1.278. The total expenditures that qualify under this bill are $489.9 million (383.3 million gallons X $1.278).

Revenue Summary

The revenue loss from exempting $489.9 million from the sales and use tax is as follows:

	Revenue Effect
State loss (5.25%)	$ 25.7 million
Local loss (2.00%)	$ 9.8 million
District loss (0.67%)	$ 3.3 million
Total	$ 38.8 million

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This staff analysis is provided to address various administrative, cost, revenue and policy issues; it is not to be construed to reflect or suggest the Board's formal position.